Supreme Court, U.S.
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No. _____ OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1997

ROGER SCHLOSSBERG, TRUSTEE,

Petitioner,

v.

STATE OF MARYLAND,
COMPTROLLER OF THE TREASURY,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITION FOR WRIT OF CERTIORARI

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59 pp

QUESTION PRESENTED

Does the Eleventh Amendment to the Constitution bar suit in federal court against the State of Maryland by a citizen of the State of Maryland acting as a trustee in bankruptcy of the estate of a Maryland corporation with its only place of business located in the State of Maryland?

LIST OF PARTIES AND RULE 29.6 LIST

The Petitioner, Appellant in the court of appeals, is Roger Schlossberg, Trustee.

The Respondent, Appellee in the court of appeals, is the State of Maryland, Comptroller of the Treasury.

The Intervenor in the court of appeals is the United States of America.

The debtor, Creative Goldsmiths of Washington, D.C., Inc., has neither a parent nor a subsidiary company.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, Roger Schlossberg, Trustee, respectfully prays that this Court issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit entered in the proceedings entitled *In re: Creative Goldsmiths of Washington, D.C., Inc., Debtor; Schlossberg v. State of Maryland, Comptroller of the Treasury,* July 22, 1997.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is reported at 119 F.3d 1140 (4th Cir., 1997), and is reprinted in the Appendix at 1 to 21. The opinion of the United States District Court for the District of Maryland (Southern Division) is reprinted in the Appendix at 22 to 33. The opinion of the United States Bankruptcy Court for the District of Maryland is reprinted in the Appendix at 34 to 35.

JURISDICTION

The United States Court of Appeals for the Fourth Circuit entered its opinion on July 22, 1997. The United States of America, Intervenor, petitioned the court of appeals for rehearing, in which Petition the Petitioner herein also joined. The court of appeals denied the Petition for Rehearing on November 20, 1997. This Petition is filed within ninety (90) days of the entry of the Order

denying the Petition for Rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES, REGULATIONS, AMENDMENTS AND CONSTITUTIONAL PROVISIONS

Constitution of the United States, art. III, sect. 2.

> The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; – to all Cases affecting Ambassadors, other public Ministers and Consuls; – to all Cases of admiralty and maritime Jurisdiction; – to Controversies to which the United States shall be a Party; – to Controversies between two or more States; – between a State and Citizens of another State; – between Citizens of different States, – between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

Constitution of the United States, amend. XI.

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

11 U.S.C. § 106. Waiver of sovereign immunity.

> **(a)** Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:

(1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.

(2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.

(3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(2)(A) of title 28.

(4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States.

(5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.

(b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

(c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

STATEMENT OF THE CASE

The instant bankruptcy case was initiated upon the filing in the United States Bankruptcy Court for the District of Maryland of an Involuntary Petition against the Debtor, Creative Goldsmiths of Washington, D.C., Inc. (the "Debtor" or "Creative") under Chapter 7 of the Bankruptcy Code[1] on March 12, 1992 (the "Filing Date"). Subsequent thereto, an Order for Relief was entered pursuant to 11 U.S.C. § 303(h) on April 16, 1992. The Petitioner Trustee was thereafter appointed as Interim Trustee therein and, pursuant to 11 U.S.C. § 702(d) became the permanent Trustee following the first meeting of creditors held pursuant to 11 U.S.C. § 541.

On April 21, 1994, the Appellant Trustee filed in the bankruptcy case his Complaint to Avoid and Recover Preference. That Complaint sought to avoid and recover

[1] 11 U.S.C. §§ 101, *et seq.* (hereinafter the "Bankruptcy Code" or the "Code").

from the Appellee Comptroller of the Treasury (the "Comptroller") a transfer of $4,382.00 (the "Transfer") made within ninety (90) days of the Filing Date as a preferential transfer pursuant to the provisions of 11 U.S.C. § 547(b). The Comptroller interposed his Answer to the Complaint alleging, *inter alia*, that said Transfer was not avoidable under the ordinary course of business defense set forth in 11 U.S.C. § 547(c)(2). The parties entered into a Stipulation (the "Stipulation") regarding all facts to be presented to the court and filed the same on December 13, 1994. On December 15, 1994, the parties made oral cross-Motions for Summary Judgment and argued the same before the bankruptcy court. At that hearing, the Bankruptcy Judge orally announced his ruling in favor of the Appellee and thereafter on August 10, 1995, entered his Order Finding Transfer Not Avoidable Under 11 U.S.C. § 547.

The Appellant timely filed his Notice of Appeal on August 15, 1995 to the United States District Court for the District of Maryland. Oral argument on the appeal was heard in the United States District Court for the District of Maryland on May 20, 1996. On May 28, 1996, the United States District Court issued its Opinion and Order affirming the August 10, 1995 Order of the Bankruptcy Court.

Appellant timely filed his Notice of Appeal to the United States Court of Appeals for the Fourth Circuit on June 17, 1996, thereby commencing the instant appellate proceedings. In its Appellee's Brief filed in the court of appeals, the Appellee Comptroller for the first time raised as a jurisdictional bar to the appeal the putative proscriptive effect of the Eleventh Amendment and

asserted that the provisions of 11 U.S.C. § 106 abrogating sovereign immunity were unconstitutional.

Oral argument on the Appeal was heard in the United States Court of Appeals for the Fourth Circuit on April 11, 1997. On June 2, 1997, the United States as Intervenor filed its Brief urging the court of appeals to find § 106 of the Bankruptcy Code constitutional. On July 22, 1997, the court of appeals issued its Opinion and Order affirming the August 15, 1995, Order of the district court. The United States timely filed its Petition for Rehearing with Suggestion for Rehearing *In Banc*. On November 21, 1997, the court of appeals filed its Corrected Order denying the United States' Petition for Rehearing with Suggestion for Rehearing *In Banc*, noting that a poll of that body failed to produce a majority thereof in favor of rehearing.[2]

Statement Of Facts

As noted in the Statement of the Case, *supra*, all facts presented to the bankruptcy court and the district court below were undisputed and the subject of the Stipulation filed by the parties on December 13, 1994. However, for purposes of the instant Petition seeking review only of the constitutional issue relied upon by the court of appeals in its decision below, your Petitioner submits

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[2] As noted in the Corrected Order, five of the members of the court of appeals (i.e., Judges Widener, Murnhehan, Ervin, Michael and Motz) voted in favor of rehearing the case *in banc*, while a majority of eight (Chief Judge Wilkinson and Judges Russell, Hall, Wilkins, Niemeyer, Hamilton, Luttig and Williams) voted to deny such rehearing.

that, in addition to the matters noted in the Statement of the Case, *supra*, the only relevant facts herein are that the Petitioner, a citizen of the State of Maryland,[3] initiated his suit below in the bankruptcy court upon a federal question naming as a defendant therein the State of Maryland.

REASONS FOR GRANTING THE WRIT

The court of appeals below decided in error that the Eleventh Amendment bars a federal court from hearing an action arising under the Constitution and the laws created thereunder where that action is brought by a trustee in bankruptcy against that State which is the home of both the trustee and the debtor for whose estate the trustee serves. In so ruling, the court of appeals relied upon this Court's prior decision in *Hans v. Louisiana*, 134 U.S. 1, 10 S.Ct. 504, 33 L.Ed. 842 (1890), and *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996).[4] Acting over 100 years ago, the *Hans*

[3] Your Petitioner notes that not only was the debtor a citizen of Maryland (see decision of court of appeals below noting that the debtor was a "Maryland corporation", 119 F.3d. 1140, 1143, App. at 4), the Petitioner is the bankruptcy trustee duly appointed by the United States Bankruptcy Court for the District of Maryland and maintains his exclusive offices in the State of Maryland.

[4] Of additional significance in this Court's consideration of the within Petition is the unsettled and developing state of this Court's recent Eleventh Amendment decisions. In its recent consideration of the subject in *Seminole Tribe*, a bare-majority of five to four declined to embrace Justice Souter's rejection of *Hans* in a case not involving a suit between a State and one of that same State's citizens – unlike the status of the plaintiff

Court expanded the ambit of the Eleventh Amendment beyond the plain language contained therein, holding for the first time that the Eleventh Amendment's jurisdictional bar extended not only to suits against States by foreign citizens and foreign States, but also to federal actions brought by a citizen against that citizen's own State. In *Seminole Tribe*, this Court, relying on *Hans*, held that under the Eleventh Amendment, the federal judiciary did not possess jurisdiction to consider a suit by an Indian tribe against a State of the United States. This Court should exercise its discretion to revisit its decision in *Hans* to determine the correctness of that decision and to determine the important question of federal law whether the Eleventh Amendment bars a suit in federal court against a State by a trustee in bankruptcy of that State acting under that statutory scheme created by Congress pursuant to the Bankruptcy Clause of Article I, sect. 8 of the Constitution. Rule 10.1, Rules of the Supreme Court.

The Eleventh Amendment provides as follows:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of

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citizen of Maryland suing the State of Maryland herein. See also, *Idaho v. Coeur d'Alene Tribe of Idaho*, ___ U.S. ___, 117 S.Ct. 2028, 138 L.Ed.2d 438 (1997) (the Justices were divided five to four). In prior recent decisions on the same subject, a steadily growing minority has repeatedly urged its concerns regarding the fundamental predicate for the majority's continuing reaffirmation of the "second Eleventh Amendment" criticized by Justice Souter in his dissent in *Seminole Tribe*. Petition, *supra* at page 9.

> the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

In its recent treatment of issues related to the Eleventh Amendment, the issues here raised were not addressed by the Court. In *Seminole Tribe*, the Court held that the federal courts were without jurisdiction to entertain suits by Indian tribes against any of the States. While that case did explore the Eleventh Amendment in the context of federal question litigation, *Seminole Tribe* did not implicate a suit against a State by a citizen of that same State. Significantly, however, in the instant case, the Plaintiff is just such a citizen of the defendant State of Maryland – a citizen expressly excluded from the proscriptive limitations of the Eleventh Amendment.[5]

As noted most succinctly by Justice Souter in his dissent in *Seminole Tribe*, the decision of this Court in *Hans* and its progeny has resulted in the creation of " . . . two Eleventh Amendments, the one ratified in 1795, the other (so-called) invented by the Court nearly a century later in *Hans v. Louisiana*." *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, ___, 116 S.Ct. 1114, 1145, 134 L.Ed.2d 252 (1996). In *Hans v. Louisiana*, the Plaintiff, a citizen of the State of Louisiana, brought suit in federal court against that State to recover the amount of certain bonds that the State had issued to him pursuant to an act of the Louisiana legislature. Louisiana objected to the proceedings in that federal forum and insisted that the federal courts were jurisdictionally barred from entertaining Hans' suit. Hans asserted that the plain language of the Eleventh Amendment revealed that it was not a bar to the

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[5] See discussion at note 3, *supra*.

suit of a citizen against his own State, but only those of citizens of another or foreign State. Notwithstanding Hans' reliance on a crystalline articulation of the Eleventh Amendment, this Court rejected such a clear reading and opined instead;

> It is true the amendment does so read, and, if there were no other reason or ground for abating his suit, it might be maintainable; and then we should have this anomalous result, that, in cases arising under the constitution or laws of the United States, a state may be sued in the federal courts by its own citizens, though it cannot be sued for a like cause of action by the citizens of other states, or of a foreign state; and may be thus sued in the federal courts, although not allowing itself to be sued in its own courts. *Hans v. Louisiana*, 134 U.S. 1, ___, 10 S.Ct. 504, 505, 33 L.Ed. 842 (1890).

Thus, without reliance upon historical fact or legal precedent, the *Hans* Court superimposed upon the Eleventh Amendment a breadth of proscription far beyond that justified by the actual language contained therein.

The Eleventh Amendment was born out of the public reaction decrying the 1793 decision of this Court in *Chisholm v. Georgia*, 2 Dall. 419, 1 L.Ed. 440 (1793). In *Chisholm*, this Court permitted the suit in federal court of a citizen of South Carolina seeking to recover damages in assumpsit from the State of Georgia. In authorizing such suit, Chief Justice Jay instructed that " . . . the extension of the judiciary power of the United States to such controversies appears to me to be *wise*, because it is *honest*, and because it is *useful*." *Chisholm v. Georgia*, 2 Dall. 419, 479, 1 L.Ed. 440 (1793).

Reacting to the Court's decision in *Chisholm*, the Eleventh Amendment was quickly proposed in 1794 and, in short order, was ratified by three-fourths of the States and became effective in 1795. Notwithstanding Chief Justice Jay's inspiring rhetoric, the States declined to cede to the federal judiciary jurisdiction over suits between the States and the citizens of other or foreign States. Careful consideration of the language included in the Eleventh Amendment further reveals its original intent and that of the States in undertaking its ratification. As drafted, the Eleventh Amendment is an express limitation on the judicial power otherwise created under Article III of the Constitution. Except to the extent that the judicial power granted in Article III is expressly circumscribed by the Eleventh Amendment, that judicial power continues in force and effect with full vitality. As such, in every case implicating the effect of the Eleventh Amendment, its language must be minutely examined to determine that which has been excised from the otherwise broad authority contained in Article III.

In the context of the instant case, the Eleventh Amendment is searched in vain for any provision which might place the Plaintiff outside the welcoming arms of the federal courts. While the Plaintiff seeks to extend " . . . the Judicial power of the United States . . . to (a) suit in law or equity . . . against one of the United States . . . ", the Plaintiff is neither a citizen " . . . of another State (nor a) Citizen or Subject of any Foreign State . . . " Indeed, as noted above, the Plaintiff is a citizen of Maryland – the very State which he desires to sue – and the only class of

citizen which is not barred access to the federal courts by the unambiguous language of the Eleventh Amendment.[6]

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[6] While not relevant to the case at bar, Justice Brennan broadly concluded in *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 301, 105 S.Ct. 3142, 3177, 87 L.Ed.2d 171 (1985) and *Welch v. Texas Dept. of Highways and Public Transp.*, 483 U.S. 495,.510-511, 107 S.Ct. 2941, 2965, 97 L.Ed.2d 389 (1987) that the Eleventh Amendment has no relevance to federal question cases without drawing the distinction between suits by a citizen against his own State as opposed to those against another State. Seeking to reconcile the lack of explicit language in the Eleventh Amendment to that effect, Justice Brennan asserted that the language of the Eleventh Amendment was drawn in parallel terms to several non-federal question clauses contained in Article III, sect. 2. As above noted, however, the instant case does not require review of Justice Brennan's theory and conclusions; the case at bar presenting only a federal question suit brought by the plaintiff trustee as a citizen of Maryland against the State of Maryland – an action plainly permitted by the express language of the Eleventh Amendment.

CONCLUSION

Upon consideration of the foregoing explication of the matters sought to be presented before this Court, your Petitioner respectfully submits that the instant case presents an important question of federal law which should be settled by this Court. As such, your Petitioner respectfully submits that the requested Writ of Certiorari should be granted.

Respectfully submitted,

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In re CREATIVE GOLDSMITHS OF WASHINGTON, D.C., INCORPORATED, Debtor.
Roger SCHLOSSBERG, Trustee, Plaintiff-Appellant,

v.

STATE OF MARYLAND, COMPTROLLER OF THE TREASURY, Defendant-Appellee,
UNITED STATES TRUSTEE, Party-in-interest,

v.

UNITED STATES of America, Intervenor.

No. 96-1895.

United States Court of Appeals, Fourth Circuit.

Argued April 11, 1997.

Decided July 22, 1997.

ARGUED: Roger Schlossberg, Schlossberg & Associates, Hagerstown, MD, for Appellant. Andrew Howard Baida, Assistant Attorney General, Annapolis, MD, for Appellee. ON BRIEF: J. Joseph Curran, Jr., Attorney General of Maryland, Gerald Langbaum, Assistant Attorney General, Annapolis, MD; Wallace E. Brooks, Sylvia J. Brokos, Comptroller of the Treasury, Baltimore, MD, for Appellee. Frank W. Hunger, Assistant Attorney General, Lynne A. Battaglia, United States Attorney for the District of Maryland, Mark B. Stern, Michael E. Robinson, Civil Division, United States Department of Justice, Washington, DC, for Intervenor.

Before HALL, WILKINS, and NIEMEYER, Circuit Judges.

Vacated and remanded with instructions to dismiss by published opinion. Judge NIEMEYER wrote the opinion, in which Judge K.K. HALL and Judge WILKINS joined.

OPINION

NIEMEYER, Circuit Judge:

Roger Schlossberg, a trustee in bankruptcy, sued the State of Maryland Comptroller of the Treasury in federal court to avoid as a preference the bankruptcy debtor's $4,382 payment of income taxes made to the state within 90 days of the filing of the bankruptcy petition. *See* 11 U.S.C. § 547(b). In the courts below, the state contended successfully that the debtor's income tax payment was not a preference because it was made in the "ordinary course of business." *See* 11 U.S.C. § 547(c)(2)(B). On the trustee's appeal to this court, the state contends for the first time that it is immune from the trustee's suit under the Eleventh Amendment, and the trustee responds that, under the Bankruptcy Code, the state is "deemed to have waived [its Eleventh Amendment] sovereign immunity" because it filed a proof of claim for sales taxes and withholding taxes. *See* 11 U.S.C. § 106(b). Because the state challenges 11 U.S.C. § 106 under the Eleventh Amendment, the United States intervened. *See* 28 U.S.C. § 2403.

Because we conclude that Congress did not have the power to abrogate the state's sovereign immunity from

federal jurisdiction and that the state did not waive its immunity with regard to the present suit, we vacate the district court's judgment for lack of jurisdiction and remand the case with instructions to dismiss the trustee's adversary action against the state.

I

On March 12, 1992, creditors of Creative Goldsmiths of Washington, D.C., Inc., a Maryland corporation, filed a petition for involuntary bankruptcy against Creative Goldsmiths under Chapter 7 of the Bankruptcy Code. The bankruptcy court appointed Roger Schlossberg as trustee for the bankruptcy estate. During the course of bankruptcy administration, the trustee filed an adversary proceeding in the bankruptcy court against the State of Maryland Comptroller of the Currency to avoid as a preference the payment of $4,382 in income taxes made by Creative Goldsmiths to the state within 90 days of the filing of the bankruptcy petition. The trustee alleged that when the taxes were paid, Creative Goldsmiths was insolvent, and as a result of the payment Maryland received more than it would have as a claimant for the taxes in the Chapter 7 proceeding. In response to the trustee's complaint, Maryland contended that the $4,382 payment was made "in the ordinary course of business between the debtor and the Comptroller, and as such, is not subject to avoidance." The parties stipulated to the following operative facts.

Pursuant to Creative Goldsmiths' application for an extension of time in which to file its 1990 corporate

income tax return, the state granted a six-month extension as provided by Maryland law. *See* Md.Code Ann. Tax-Gen'l Art. § 10-823; Md. Regs.Code tit. 03 § 04.03.04(C). Creative Goldsmiths had filed for and obtained similar extensions in each of the two preceding tax years. With the extension for filing its 1990 income tax return, Creative Goldsmiths was required to pay taxes still owed, as well as any penalties and interest due, by December 14, 1991.

Within the extension period, Creative Goldsmiths paid Maryland $4,382 in taxes but paid no penalties or interest. At the time Creative Goldsmiths paid its taxes, it was insolvent and it made payment within 90 days of the subsequently filed involuntary petition in bankruptcy.

Although Creative Goldsmiths owed Maryland $1,653.48 in interest and penalties with respect to its 1990 corporate income taxes, the state did not seek relief from the automatic stay imposed by statute, *see* 11 U.S.C. § 362, or otherwise attempt to improve its position for payment of that sum. Moreover, it did not file a proof of claim for it. But Maryland did file a proof of claim for $1,400.85 in sales taxes and withholding taxes that Creative Goldsmiths collected or should have collected from third persons.

On cross-motions for summary judgment, the bankruptcy court ruled in favor of Maryland, concluding that "the Transfer, in the amount of $4,382 to the Comptroller of the Treasury, was made in the ordinary course of business and is not avoidable under 11 U.S.C. § 547." The district court affirmed and entered judgment in favor of Maryland. This appeal followed.

II

The trustee, observing that the state raises Eleventh Amendment immunity for the first time on this appeal, contends that in any event the Bankruptcy Code, 11 U.S.C. § 106(a) abrogates that immunity and authorizes his action against the state. He also argues that Maryland waived any sovereign immunity by filing a proof of claim in the bankruptcy court for sales taxes and withholding taxes. *See* 11 U.S.C. § 106(b). Accordingly, we address first the question of whether Maryland can assert Eleventh Amendment immunity for the first time on appeal.

The Eleventh Amendment provides, "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." It is well-established that this bar to suits against states in federal courts applies not only to actions brought by citizens of another state, but also to those brought by citizens of the state involved. *See Hans v. Louisiana*, 134 U.S. 1, 10, 10 S.Ct. 504, 505, 33 L.Ed. 842 (1890). The Eleventh Amendment confirms that each state is a sovereign entity and that "it is inherent in the nature of sovereignty not to be amenable to the suit of an individual without its consent." *Seminole Tribe of Florida v. Florida*, ___ U.S. ___, ___, 116 S.Ct. 1114, 1122, 134 L.Ed.2d 252 (1996) (internal quotations and citations omitted). Accordingly, the Supreme Court has long held that "[t]his express constitutional limitation denies to the federal courts authority to entertain a suit brought by private parties against a state without its consent." *Ford Motor Co.*

v. Department of Treasury of Indiana, 323 U.S. 459, 464, 65 S.Ct. 347, 351, 89 L.Ed. 389 (1945).

Although Maryland did not assert its Eleventh Amendment immunity in the courts below, "it has been well settled since the decision in *Ford Motor Co. v. Department of Treasury* . . . that the Eleventh Amendment defense sufficiently partakes of the nature of *a jurisdictional bar* so that it need not be raised in the trial court." *Edelman v. Jordan*, 415 U.S. 651, 677-78, 94 S.Ct. 1347, 1363, 39 L.Ed.2d 662 (1974) (emphasis added). The Court in *Ford Motor* explained:

> The Eleventh Amendment declares a policy and sets forth an explicit limitation on federal judicial power of such compelling force that this Court will consider the issue arising under this Amendment in this case even though urged for the first time in this Court.

323 U.S. at 467, 65 S.Ct. at 352.

Accordingly, even though Maryland asserts Eleventh Amendment immunity for the first time on appeal, we will consider the defense.

III

The trustee contends that after the Supreme Court's decision in *Hoffman v. Connecticut Dep't of Income Maintenance*, 492 U.S. 96, 101, 109 S.Ct. 2818, 2822, 106 L.Ed.2d 76 (1989), which stated that "to abrogate the States' Eleventh Amendment immunity from suit in federal court- . . . Congress must make its intention 'unmistakably clear in the language of the statute,' " Congress enacted the Bankruptcy Improvement Act of 1994, 11 U.S.C. § 106,

expressly abrogating the state's sovereign immunity. *See also United States v. Nordic Village, Inc.*, 503 U.S. 30, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992) (stating that former 11 U.S.C. § 106(c) is not sufficiently unequivocal to waive immunity). The language of new § 106(a), entitled "Waiver of sovereign immunity," would seem to confirm the trustee's argument that Congress has now clearly abrogated state sovereign immunity from suit in federal court. That section reads in pertinent part:

> Notwithstanding an assertion of sovereign immunity, sovereign immunity *is abrogated as to a governmental unit* [including a state] to the extent set forth in this section with respect to the following:
>
> (1) Sections . . . 106 [and] . . . 547 . . . of this title.
>
> (2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.
>
> (3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. . . .
>
> (4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States. (Emphasis added).

Accordingly, the trustee contends that Congress abrogated Eleventh Amendment immunity both for his 11 U.S.C. § 547 action against Maryland and with respect to other provisions of 11 U.S.C. § 106 that define the circumstances in which a state waives immunity.

While the trustee's arguments based on the clarity of Congress' intent are supportable as far as he takes them, he fails to recognize that following the enactment of the Bankruptcy Reform Act of 1994, the Supreme Court emphasized that any Eleventh Amendment analysis must also include an inquiry into whether Congress has the power to abrogate a state's sovereign immunity. *See Seminole*, ___ U.S. at ___-___, 116 S.Ct. at 1124-25. That case reminds us that the Constitution establishes a federal government of enumerated powers whose boundaries must be observed.

Were we to read only the Bankruptcy Clause of the Constitution, art. I, § 8, cl. 4 (conferring on Congress the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States"), and Article III (authorizing Congress to vest the judicial power of the United States in lower federal courts), we might readily conclude that the states in subscribing to the Constitution conferred on the federal government the power to enact bankruptcy laws for enforcement in federal courts which, for that purpose, would have jurisdiction over the states. But as the Court in *Seminole* instructed, a proper understanding of the structural balance between state sovereignty and congressional power must take into account the effects of the Eleventh and Fourteenth Amendments.

As *Seminole* explains, the Eleventh Amendment was passed to counteract an expansion of federal jurisdiction to suits by private persons against unconsenting states, which had never been contemplated by the founders in establishing the judicial power under Article III. *See Seminole*, ___ U.S. at ___, ___-___, 116 S.Ct. at 1124, 1130-32. The Eleventh Amendment thus expressly limited federal judicial power over the states. Accordingly, to give the Eleventh Amendment effect, Congress' powers under Article I cannot be construed to empower it to expand federal jurisdiction by abrogating the states' sovereign immunities.

To apply these principles to a federal statute passed pursuant to the Indian Commerce Clause, U.S. Const. art. I, § 8, cl. 3, which clearly purported to abrogate the states' sovereign immunities, the Court in *Seminole* posed the fundamental question, "Was the Act in question passed pursuant to a constitutional provision granting Congress the power to abrogate?" *Seminole*, ___ U.S. at ___, 116 S.Ct. at 1125. The Court answered that question in the negative, explaining:

> Even when the Constitution vests in Congress complete lawmaking authority over a particular area, the Eleventh Amendment prevents congressional authorization of suits by private parties against unconsenting States. The Eleventh Amendment restricts the judicial power under Article III, and Article I cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction.
>
> *Seminole*, ___ U.S. at ___-___, 116 S.Ct. at 1131-32. The Court thereby overruled its only prior case finding congressional authority to

abrogate state sovereign immunity pursuant to an Article I power – a plurality opinion in *Pennsylvania v. Union Gas Co.*, 491 U.S. 1, 109 S.Ct. 2273, 105 L.Ed.2d 1 (1989), that had found such power in the Commerce Clause, U.S. Const. art. I, § 8, cl. 3.

Because the holding in *Seminole* extended to restrict all federal jurisdiction over the states based on Article I powers, we hold in this case that Congress has no authority under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4, to abrogate state sovereign immunity in federal courts. We find unpersuasive the argument of the United States that the Bankruptcy Clause's provision for the enactment of "*uniform* laws on the subject of Bankruptcies," *id.* (emphasis added), requires Congressional powers under this clause to be distinguished from other Article I powers for purpose of reconciliation with the restraints imposed by the Eleventh Amendment. As Justice Marshall observed in his dissenting opinion in *Hoffman*,

> I see no reason to treat Congress' power under the Bankruptcy Clause any differently [than the Commerce Clause power, as addressed in *Union Gas*], for both constitutional provisions give Congress plenary power over national economic activity. See The Federalist No. 42, p. 271 (C. Rossiter ed. 1961) (J. Madison) (describing the Bankruptcy Clause and the Commerce Clause as "intimately connected").

Hoffman, 492 U.S. at 111, 109 S.Ct. at 2828 (Marshall, J., dissenting).

Despite its recognition of the limitations placed on Article I powers by the Eleventh Amendment, the *Seminole* Court did acknowledge a legitimate source of congressional power to abrogate states' immunities. Section 5 of the Fourteenth Amendment, which was ratified 70 years after the Eleventh Amendment, appears to take back some of the earlier amendment's limitations because, "by expanding federal power at the expense of state autonomy, [it] fundamentally altered the balance of state and federal power struck by the Constitution" and "expressly provided that 'The Congress shall have the power to enforce, by appropriate legislation, the provisions of this article.' " *Seminole*, ___ U.S. at ___, 116 U.S. at 1125 (quoting U.S. Const. amend. XIV, § 5). "As a result, when acting pursuant to § 5 of the Fourteenth Amendment, Congress can abrogate the Eleventh Amendment without the States' consent." *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 238, 105 S.Ct. 3142, 3145, 87 L.Ed.2d 171 (1985); *see also Fitzpatrick v. Bitzer*, 427 U.S. 445, 456, 96 S.Ct. 2666, 2671, 49 L.Ed.2d 614 (1976). The United States thus urges us to sustain § 106 under the authority granted Congress by § 5 of the Fourteenth Amendment. But as the Supreme Court's recent pronouncement in *City of Boerne v. Flores* indicates, § 5 of the Fourteenth Amendment does not grant Congress a plenary power. ___ U.S. ___, ___-___, 117 S.Ct. 2157, 2167-68, 138 L.Ed.2d 624 (1997) ("Any suggestion that Congress has a substantive non-remedial power under the Fourteenth Amendment is not supported by our case law.").

In this case, there is no evidence to indicate that in enacting the Bankruptcy Reform Act of 1994, Congress

acted under § 5 of the Fourteenth Amendment. *See Seminole*, ___ U.S. at ___, 116 S.Ct. at 1125 (stating that operative question is under what constitutional provision an act of Congress was passed and noting that litigants had not challenged lower court's finding that Indian gaming regulation was not passed pursuant to Fourteenth Amendment). Indeed, the conclusion seems logically inescapable that in passing the 1994 Act Congress exercised the same specifically enumerated Article I bankruptcy power that it has traditionally relied on in enacting prior incarnations of the bankruptcy law dating back to 1800 – 68 years before the passage of the Fourteenth Amendment. *See* Law of Apr. 4, 1800, ch. 19, 2. Stat. 19 (repealed 1803). We will not presume that Congress intended to enact a law under a general Fourteenth Amendment power to remedy an unspecified violation of rights when a specific, substantive Article I power clearly enabled the law.

Furthermore, reliance on § 5 of the Fourteenth Amendment as a post hoc justification for Congress's attempted abrogation in 11 U.S.C. § 106 would require us to ignore the result in *Seminole*. It is self-evident that the Fourteenth Amendment protects individuals from state deprivations of property without due process of law and thus, at some level of generality, could arguably apply to authorize bankruptcy court adjudications of property rights. *But see City of Boerne*, ___ U.S. at ___-___, 117 S.Ct. at 2165-66 ("The Enforcement Clause [of the Fourteenth Amendment] . . . did not authorize Congress to pass 'general legislation upon the rights of the citizen, but corrective legislation. . . . ' The power to 'legislate generally upon' life, liberty, and property, as opposed to the

'power to provide modes of redress' against offensive state action, was 'repugnant' to the Constitution.") (citations omitted). If the Fourteenth Amendment is held to apply so broadly as to justify Congress' enactment of the Bankruptcy Code as a requirement of due process, then the same argument would justify every federal enforcement scheme as a requirement of due process under the Fourteenth Amendment. Clearly, the Indian gaming regulation at issue in *Seminole* would itself have been subject to this style of constitutionalization, for the statute provided for arbitration enforceable in federal court and governed property rights in the form of future gaming proceeds. Thus, *Seminole* itself is inconsistent with any reading that would extend Congressional power under § 5 of the Fourteenth Amendment to reincorporate express Article I powers.

In summary, we conclude in light of *Seminole* that Congress is not empowered to use Article I authority, specifically the Bankruptcy Clause, to circumvent the Eleventh Amendment's restriction on federal jurisdiction. Because there is no evidence that Congress either passed the Bankruptcy Code under § 5 of the Fourteenth Amendment or sought to preserve the core values specifically enumerated in that amendment, we hold that Congress' effort to abrogate the states' Eleventh Amendment immunity through its 1994 enactment of 11 U.S.C. § 106(a) is unconstitutional and ineffective. *See Seminole*, ___ U.S. at ___-___, 116 S.Ct. at 1131-32.

Because 11 U.S.C. § 106(a) purports to abrogate state immunity also for § 106(b), our analysis likewise applies to § 106(b). But even the language of 11 U.S.C. § 106(b) itself – that a state is *"deemed* to have waived sovereign

immunity" – amounts to language of abrogation. In that section, Congress unequivocally purports to say when states have no immunity from private suits in federal court. *Cf. United States v. Nordic Village, Inc.*, 503 U.S. 30, 34, 112 S.Ct. 1011, 1014-15, 117 L.Ed.2d 181 (1992) (11 U.S.C. § 106(b), then numbered § 106(a), is an unequivocal expression that governmental units, including states, waive sovereign immunity). While 11 U.S.C. § 106(b) may correctly describe those actions that, as a matter of constitutional law, constitute a state's waiver of the Eleventh Amendment, it is nevertheless not within Congress' power to abrogate such immunity by "deeming" a waiver. Rather, in the absence of a constitutional authorization, it lies solely within a state's sovereign power to waive its immunity voluntarily and to consent to federal jurisdiction. Only if it waives such immunity may a private citizen sue the state in federal court.

IV

In considering whether a state has waived its Eleventh Amendment immunity, the Supreme Court has consistently held that "a State will be deemed to have waived its immunity only where [the waiver is] stated by the most express language or by such overwhelming implication from the text as will leave no room for any other reasonable construction." *Atascadero*, 473 U.S. at 239-40, 105 S.Ct. at 3146 (internal quotations omitted). The court explained:

> A State may effectuate a waiver of its constitutional immunity by a state statute or constitutional provision, or by otherwise waiving its immunity to suit in the context of a particular

> federal program. In each of these situations, we require an unequivocal indication that the State intends to consent to federal jurisdiction that otherwise would be barred by the Eleventh Amendment. As we said in *Edelman v. Jordan*, 415 U.S. 651, 673 [94 S.Ct. 1347, 1360-61, 39 L.Ed.2d 662] (1974), "constructive consent is not a doctrine commonly associated with the surrender of constitutional rights, and we see no place for it here."

Id. at 238 n. 1, 105 S.Ct. at 3145 n. 1.

Determining whether a state has waived its Eleventh Amendment immunity and consented to federal jurisdiction requires us first to look at the state's law. In *Ford Motor*, the State of Indiana defended on the merits against a diversity suit for a state tax refund brought in federal court under the state's own law, and it did not raise the Eleventh Amendment objection until its appeal reached the Supreme Court. In examining whether Indiana had waived its Eleventh Amendment immunity, the Supreme Court concluded that the state law authorizing refunds should be construed narrowly and that, therefore, its law waived sovereign immunity only for refund suits brought in *state* court. *See Ford Motor*, 323 U.S. at 465-66, 65 S.Ct. at 351-52; *accord Atascadero*, 473 U.S. at 241, 105 S.Ct. at 3146-47; *Barfield v. Blackwood* (*In re Sec. of Dep't of Crime Control and Public Safety*), 7 F.3d 1140, 1146-47 (4th Cir.1993) (Eleventh Amendment immunity not waived by statute requiring state to pay judgments awarded by courts of competent jurisdiction against state employees, even if the statute waived immunity in state courts); *Westinghouse Elec. Corp. v. West Virginia Dep't of Highways*,

845 F.2d 468, 471 (4th Cir.1988) (statutes precluding assertion of "constitutional immunity" or "governmental status" at most waived immunity in state courts). The absence of a specific state statute waiving the state's immunity did not, however, conclude the Supreme Court's analysis in *Ford Motor.* The Court stated:

> It remains to be considered whether the attorney general for the State of Indiana in his conduct of the present proceeding has waived the state's immunity from suit. The state attorney general is authorized to represent the state in actions brought under the Indiana refund statute. He appeared in the federal District Court and the Circuit Court of Appeals and defended the suit on the merits.
>
> * * *
>
> It is conceded by the respondents that if it is within the power of the administrative and executive offices of Indiana to waive the state's immunity, they have done so in this proceeding. *The issue thus becomes one of their power under state law to do so.* As this issue has not been determined by state courts, this Court must resort to the general policy of the state as expressed in its Constitution, statutes and decisions.

Ford Motor, 323 U.S. at 466-67, 65 S.Ct. at 352 (footnotes omitted) (emphasis added). After examining the relevant state constitutional provisions and case law, which required any waiver of sovereign immunity to apply to an entire category of cases and which did not grant the Indiana Attorney General the power to make

case-by-case waiver decisions, the *Ford Motor* Court concluded that no properly authorized state official had waived the state's Eleventh Amendment immunity and thus that the federal courts lacked jurisdiction. *See id.* at 468-69, 65 S.Ct. at 352-53. In sum, the Supreme Court indicated that a state's consent to be sued in federal court must be clearly intended by its state law and implemented by an officer acting properly under that law.

As we look to state law to determine whether the state has waived sovereign immunity and whether its officers have properly acted under that law, we also look to state law when a state has voluntarily initiated an action in federal court to determine whether the state officer is authorized to proceed in federal court. Only if we determine that he has such an authority do we look to federal law to determine the scope of waiver attending the state's federal suit. The Eleventh Amendment, which applies only to suits "commenced or prosecuted *against* one of the United States," presents no bar to a state affirmatively entering a federal forum voluntarily to pursue its own interest. But it would violate the fundamental fairness of judicial process to allow a state to proceed in federal court and at the same time strip the defendant of valid defenses because they might be construed to be affirmative claims *against* the state. When a state authorizes its officials voluntarily to invoke federal process in a federal forum, the state thereby consents to the federal forum's rules of procedure and may not invoke sovereign immunity to protect itself against the interposition of defenses to its action. The scope of these available defenses and the state's concomitant waiver of immunity is a question of federal law and procedure, but well-

established principles of sovereign immunity dictate that this waiver be narrowly construed. *See, e.g., Atascadero,* 473 U.S. at 239-40, 105 S.Ct. at 3146. For this reason, we hold that to the extent a defendant's assertions in a state-instituted federal action, including those made with regard to a state-filed proof of claim in a bankruptcy action, amount to a *compulsory* counterclaim, a state has waived any Eleventh Amendment immunity against that counterclaim in order to avail itself of the federal forum.

With these principles in hand, we turn first to Maryland law to determine whether the state has waived its Eleventh Amendment immunity and whether the state's officers were authorized to act in the federal bankruptcy forum, and then to federal law to determine whether the state's filing of a proof of claim or other participation in the bankruptcy court on the merits effected a waiver of immunity to the trustee's action before us.

Under state law, in Maryland's own courts, "[a] waiver of sovereign or governmental immunity from suit generally requires that two conditions be met. First, the Legislature must authorize suits for damages, and second, there must be provision for the payment of judgments." *Kee v. State Highway Administration,* 313 Md. 445, 545 A.2d 1312, 1317 (1988). State courts maintain this requirement of legislative authorization for waiver of immunity despite the fact that under the Maryland Constitution, art. V, § 3:

> (a) The Attorney General shall:
>
> (1) Prosecute and defend on the part of the State all cases pending in the appellate courts of the State, in the Supreme Court of the United

> States or the inferior Federal Courts, by or against the State, or in which the State may be interested, except those criminal appeals otherwise prescribed by the General Assembly.
>
> (2) Investigate, commence, and prosecute or defend any civil or criminal suit or action or category of such suits or actions in any of the Federal Courts or in any Court of this State, or before administrative agencies and quasi legislative bodies, on the part of the State or in which the State may be interested, which the General Assembly by law or joint resolution, or the Governor, shall have directed or shall direct to be investigated, commenced and prosecuted or defended.

While this constitutional language undoubtedly grants the Maryland Attorney General authority to defend federal suits, including the current bankruptcy action, it does not unequivocally grant him the authority to waive the state's sovereign immunity, as required by *Atascadero* and like cases. Nor is there a necessary implication of such authority, because the Attorney General may, as in this case, defend an action brought in federal court by asserting Eleventh Amendment immunity.

Thus, we conclude that Maryland's defense of this case on the merits in the district court does not indicate a waiver of Eleventh Amendment immunity. Absent legislative authorization, the Maryland Attorney General's power to waive the state's immunity under the Eleventh Amendment is strongly circumscribed. We are satisfied that the action taken in this bankruptcy has not waived the state's immunity with regard to the trustee's action to avoid and recover the payment of income taxes.

Maryland did, however, file an affirmative proof of claim in the debtor's bankruptcy to recover from the bankruptcy estate sales and withholding taxes which the debtor collected for the state from third parties (i.e. employees and clients of the debtor). Under state law, the debtor was obligated to collect these taxes and hold them in trust for the state. *See* Md.Code Ann. Tax-Gen'l Art. § 10-906 (withholding of employees' income taxes); Tax-Gen'l Art. § 11-401 (collecting sales and use taxes). The trustee's action in this case, however, to avoid the payment of the debtor's corporate income taxes, does not arise out of the same transaction or occurrence supporting Maryland's proof of claim for unrelated taxes. Thus, this action by the trustee cannot be construed under federal law as a claim in the nature of a compulsory counterclaim to the state's proof of claim. *See* Fed.R.Civ.P. 13(a) (compulsory counterclaims), made applicable to bankruptcy proceedings, Fed. R. Bankr.P. 7013.

Because of the procedural and factual context of this case, our holding does not reach any defenses that the trustee may have to the state's proof of claim for sales taxes and withholding taxes collected by the debtor from third persons or the possibility of a setoff to that claim in the nature of a permissive counterclaim. Because the trustee has neither pleaded a setoff in this case nor sought to allege a claim in the nature of a permissive counterclaim, we do not have occasion to decide to what extent sovereign immunity might be waived with respect to a setoff. Any consideration of these issues by us would have to await a final order processing the state's proof of claim on the unrelated tax claims.

Accordingly, because we have no "authority to entertain" this action absent Maryland's consent, *see Ford Motor*, 323 U.S. at 464, 65 S.Ct. at 351, we vacate the judgment and remand with instructions to dismiss this adversary action between the trustee and the State of Maryland.

IT IS SO ORDERED.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

IN RE:	*	Bankruptcy
CREATIVE GOLDSMITHS OF WASHINGTON, D.C., INC.	*	No. 92-1-1468-SD.
	*	Chapter 7
Debtor	*	
	*	

* * * * * * * * * * * * * * * *

ROGER SCHLOSSBERG, TRUSTEE	*	
	*	
Appellant	*	Civil No.
	*	PJM 95-2693
v.	*	
	*	
STATE OF MARYLAND COMPTROLLER OF THE TREASURY	*	
	*	
	*	
	*	
Appellee	*	

OPINION

I.

Roger Schlossberg, a Chapter 7 Trustee in bankruptcy, has brought an adversary proceeding to avoid, as a preferential transfer, a corporate income tax payment Debtor Creative Goldsmith of Washington, D.C., Inc. made to the Maryland Comptroller of the Treasury less than 90 days before filing for bankruptcy. The Bankruptcy Court, Judge Duncan W. Keir, found the transfer non-avoidable based on the ordinary course of business defense. Trustee appeals from that decision.

II.

The parties have stipulated to the facts.

The bankruptcy proceeding was initiated on March 12, 1992 with the filing of an involuntary petition against Debtor under Chapter 7 of the Bankruptcy Code. On December 15, 1991, within 90 days of the bankruptcy filing (as of a time the parties agree Debtor was insolvent), Debtor paid Comptroller the sum of $4,382.00, representing corporate income tax due from Debtor to the State of Maryland for fiscal year 1990.[1] Debtor was required to file its 1990 corporate income tax return with the State by June 15, 1991, but had requested and received an extension to file the same by not later than December 15, 1991. Comptroller granted this extension pursuant to the Code of Maryland Regulations, COMAR 03.04.03.04, which provides as follows:

> A. A corporation shall file a corporation income tax return by the 15th day of the 3rd month following the end of the tax year of period. The return shall be filed with a copy of the federal return for the corresponding tax year or period.
>
> B. Certain organizations that are afforded a later due date for filing federal returns under the Internal Revenue Code shall be afforded the same later due date for filing Maryland income tax returns.

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[1] Judge Keir found that payment had been mailed and made by December 15, 1994, as opposed to December 19, the date Debtor's check was deposited to Comptroller's bank account. The parties do not challenge this factual finding on appeal.

C. Extension of Time to File.

(1) A corporation unable to file by the due date shall file an Application for Extension of Time to File Corporation Income Tax Return.

(2) The application shall be filed by the original due date and extends only the time allowed to file the income tax return.

(3) A declaration of estimated income tax payment shall be due by the 15th day of the 4th, 6th, 9th, and 12th month following the beginning of the tax year or period.

(4) The total estimated tax payments for the year shall be at least 90 percent of the tax developed for the current taxable year or 100 percent of the tax developed for the prior tax year.

(5) At least 25 percent of the total estimated tax shall be remitted by each of the four installment due dates.

(6) For a short tax period, the total estimated tax for the taxable period shall be paid equally over the number of installment due dates occurring during the short tax year. However, estimated tax need not be paid for a short period of less than 4 months.

(7) Assessment of interest and penalty for underpayment of estimated tax shall

> be based on the tax for the current taxable year.[2]

COMAR 03.04.03.04.

Trustee argues that Debtor's payment of the tax was a voidable preference under 11 U.S.C. §547(b). Comptroller contends that payment was made in the ordinary course of business and is thus, pursuant to 11 U.S.C. §547(c)(2), nonavoidable.

III.

In *Advo-System Inc. v. Maxway Corp.*, 37 F.3d 1044 (4th Cir. 1994), the U.S. Court of Appeals for the Fourth Circuit summarized the law applicable to this case:

> Generally, when a debtor makes a payment to an unsecured creditor within 90 days before a bankruptcy petition is filed, that payment is a "preference." *See* 11 U.S.C. §547(b). The trustee in bankruptcy may recover such a payment from the unsecured creditor, thereby forcing that creditor to stand at the back of the line with the rest of the debtor's unsecured creditors. However, the unsecured creditor has several shields with which it can defend against the trustee's avoidance power. *See* 11 U.S.C. §547(c). One such shield, and a prominent one at that, is found in §547(c)(2); it is known as the "ordinary course of business" exception.

37 F.3d at 1045-46.

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[2] The parties stipulate that this provision authorizes Comptroller to grant a six-month extension as was given Debtor here.

Section 547(c)(2) of the Bankruptcy Code provides in pertinent part that the trustee may not avoid a transfer:

> (2) to the extent that such transfer was –
>
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms.

11 U.S.C. §547(c)(2).

Comptroller has the burden of proving by a preponderance of evidence that the payment to it satisfies these three subsections. *Maxway*, 37 F.3d at 1047.

Trustee concedes that Debtor's payment to Comptroller was incurred in the ordinary course of business of both parties, *i.e.* the payment of taxes by Debtor and receipt of same by Comptroller were within the ordinary course of business or financial affairs of Debtor and Comptroller. *See In re Cleveland Graphic Reproduction, Inc.*, 78 B.R. 819, 822 (N.D. Ohio 1987). Accordingly, Comptroller satisfies Subsection A.

It also appears that Trustee does not dispute Comptroller's compliance with Subsection B. Payment of the tax within the automatic extension period was in fact made in the ordinary course of business between Debtor

and Comptroller.[3] The evidence before Judge Keir indicated that Debtor had received two previous six-month extensions from Comptroller for the payment of its corporate income tax for the years 1988 and 1989.

The dispute in this case centers around Subsection C, *i.e.* whether the transfer was made according to ordinary business terms in the industry. Again *Maxway* disposes upon the law:

> Subsection C says that payments must be "made according to ordinary business terms." 11 U.S.C. §547(c)(2)(C). What does this phrase mean? Specifically, what is the appropriate benchmark from which we determine whether a preference payment's credit terms are "ordinary"? The Code does not tell us. In fact, the Code fails to define any of the phrases in §547(c)(2). Section 547(c)(2)'s legislative history tells us simply that the "purpose of this exception is to leave undisturbed normal financial relations, because it [such an exception to the trustee's general avoidance powers] does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." S.Rep. No. 989, 95th Cong., 2d Sess. 88 (1978), reprinted in 1978, U.S.C.C.A.N. 5787, 5874.

37 F.3d at 1047.

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[3] Late payments, if part of the standard course of dealing of the parties, may still be considered within the ordinary course of business under §547(c)(2)(B). *In Re Transport Associates, Inc.*, 171 B.R. 232, 236 (W.D. Ky. 1994).

And further,

> [W]e read subsection C as establishing the requirement that a creditor prove that the debtor made its pre-petition preferential transfers in harmony with the range of terms prevailing as some relevant industry's norms. That is, subsection C allows the creditor considerable latitude in defining what the relevant industry is, and even departures from that relevant industry's norms which are not so flagrant as to be "unusual" remain within subsection C's protection. In addition, when the parties have had an enduring, steady relationship, one whose terms have not significantly changed during the pre-petition insolvency period, the creditor will be able to depart substantially from the range of terms established under the objective industry standard inquiry and still find a haven in subsection C.
>
> Molded Acoustical, 18 F.3d at 226. But subsection C never tolerates a gross departure from the industry norm, not even when the parties have had an established and steady relationship. See id.

37 F.3d at 1050 [quoting *Fiber Lite Corp. v. Molded Acoustical Prods., Inc.*, 18 F.3d 217, 226 (3d Cir. 1994)].

Trustee argues that *Maxway* requires Comptroller to have presented evidence to the Bankruptcy Court that Debtor's late payment of taxes pursuant to a six-month extension was in conformity with existing credit standards in an identified industry. Comptroller responds that it was unnecessary to produce documentary or testimonial evidence in this regard; that the "relevant industry" was the Maryland taxing authority itself; and the

COMAR 03.04.03.04, the regulation pursuant to which payers of Maryland Corporate income taxes may obtain an extension of time to pay, establishes the industry's standard. The Bankruptcy Judge agreed with Comptroller's view and so does the Court.

IV.

While Trustee suggests that Comptroller fails to identify the relevant industry, he is not entirely clear what the contours of that industry might be, *e.g.* whether it comprises all state taxing authorities in the United States, all such authorities regionally, or whether a single state authority will do. But " . . . the identification of the industry whose standards should obtain would many times be problematic . . . [T]he approach we will employee, though still requiring that the creditors make some showing of an industry standard is quite accommodating about what the proper industry is, ameliorating this sometimes intractable problem." *Molded Acoustical Products, Inc.*, 18 F.3d at 224.

The Court is satisfied, under this relatively relaxed standard, that the Comptroller's office itself, as the collector of all corporate income taxes in the State of Maryland, is the relevant industry. *See Maxway*, 37 F.3d at 1050.[4] Further, the Court concludes that Comptroller's "general credit practices," *i.e.* its customary terms for the late payment of corporate income taxes, are set out in

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[4] This is not necessarily to say that a taxing authority less than state-wide in scope would qualify as a relevant industry for purposes of this exception.

COMAR 03.04.03.04. The regulation establishes that extensions for payment of the tax will be granted so long as appropriate interest and penalties are paid. No distinctions are made as to which corporations may qualify for this benefit nor as to the terms upon which the extension will be conceded. The parties have stipulated that Debtor availed itself of the extension of time to file on Comptroller's "usual terms."[5] Moreover, as the Maryland's [sic] taxing authority, Comptroller's "presolvency relationship" with Debtor was "both steady and well established."

Trustee's insistence that Comptroller was obliged to show how many taxpayers, in a given period, in fact availed themselves of the provisions to file taxes late and how many of those taxpayers actually made the payments would result in a needless exercise. The short answer is that whether one corporation or one thousand corporations sought the extension, each would automatically have obtained it on the same terms and conditions as Debtor. The fact that few or many corporations actually sought the "credit" would not alter what the "ordinary business terms" for late filing were.

The Court is thus persuaded that Comptroller's evidentiary base before the Bankruptcy Court was sufficient. This conclusion harmonizes with the purpose of the ordinary course of business exception "to leave undisturbed normal financing operations" while not detracting from

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[5] While Debtor in fact eventually paid only the base tax without interest and penalties, that obviously was because Debtor was insolvent, not because it had been granted unusual payment terms.

"the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." S.Rep. No. 989, 95th Cong., 2d Sess. 88 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5874 (1977), cited in *Maxway*, 37 F.3d at 1047. Comptroller has met its burden of showing that the preference payment satisfies the "ordinary business term" requirement of §547(c)(2)(c). Since all three prongs of ordinary course of business exception have been established, Trustee may not recover the preferential transfer to Comptroller.

The decision of the Bankruptcy Court will be AFFIRMED.

A separate Order implementing this Opinion will be filed.

/s/ PETER J. MESSITTE
UNITED STATES DISTRICT JUDGE

May 28, 1996

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

IN RE:	*	Bankruptcy
	*	No. 92-1-1468-SD
CREATIVE GOLDSMITHS OF WASHINGTON, D.C., INC.	*	Chapter 7
	*	
Debtor	*	
	*	
* * * * * * * * * * * *		
ROGER SCHLOSSBERG, TRUSTEE	*	
	*	
	*	Civil No.
Appellant	*	PJM 95-2693
v.	*	
	*	
STATE OF MARYLAND COMPTROLLER OF THE TREASURY	*	
	*	
	*	
Appellee	*	

FINAL ORDER

The Court having considered Appellant Roger Schlossberg Trustee's Appeal from the Order of the Bankruptcy Court dated August 10, 1995, and Appellee Maryland Comptroller of the Treasury's Opposition thereto, it is for the reasons stated on the record, this 28th day of May, 1996. .

ORDERED that the Order of the Bankruptcy Court dated August 10, 1995, is hereby AFFIRMED, and it is further

ORDERED that judgment is hereby entered in favor of Appellee Maryland Comptroller of the Treasury.

/s/ PETER J. MESSITTE
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND

IN RE:	*	
CREATIVE GOLDSMITHS	*	CASE NO.
OF WASHINGTON, D.C., INC.	*	92-1-1468-SD
Debtor	*	(Chapter 7)
	*	
	* * * * *	
	*	
ROGER SCHOLOSSBERG,	*	
TRUSTEE	*	ADVERSARY NO.
Plaintiff	*	94-1-A377-DK
	*	
vs.	*	
	*	
STATE OF MARYLAND	*	
COMPTROLLER OF THE	*	
TREASURY	*	
Defendant	*	
	* * * * * * * * * *	

ORDER FINDING TRANSFER
NOT AVOIDABLE UNDER 11 U.S.C. § 547

(Entered Aug. 10, 1995)

Upon the stipulations agreed to by the parties, upon their oral motions for summary judgment in open court, counsel for both parties having been heard, it is this 10th day of January, 1995,

ORDERED, that the Plaintiff's motion for summary judgment is hereby denied; and it is further

ORDERED, that the Defendant's motion for summary judgment is hereby granted and that the Transfer, in the amount of $4,382.00 to the Comptroller of the Treasury,

was made in the ordinary course of business and is not avoidable under 11 U.S.C. § 547.

/s/ Duncan W. Keir
Duncan W. Keir
United States Bankruptcy
Judge

cc: Roger Schlossberg
Schlossberg & Associates
134 West Washington Street
P. O. Box 4227
Hagerstown, MD 21741-4227

Sylvia J. Brokos
Comptroller of the Treasury
State of Maryland
301 W. Preston Street, Room 315
Baltimore, MD 21201

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND

IN RE:	*	
CREATIVE GOLDSMITHS	*	CASE NO.
OF WASHINGTON, D.C., INC.	*	92-1-1468-SD
Debtor	*	(Chapter 7)
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ROGER SCHOLOSSBERG,	*	
TRUSTEE	*	ADVERSARY NO.
Plaintiff	*	94-1-A377-DK
vs.	*	
STATE OF MARYLAND	*	
COMPTROLLER OF THE	*	
TREASURY	*	
Defendant	*	
	* * * * * * * * * * *	

STIPULATION

(Received Dec. 13, 1994)

Roger Schlossberg, Trustee, Plaintiff, and the Comptroller of the Treasury of the State of Maryland, Defendant, hereby stipulate as follows:

1. Creative Goldsmiths issued check number 4281 (the "check") in the amount of $4,382.00 payable to the Comptroller of the Treasury on December 13, 1991.

2. The Comptroller of the Treasury negotiated the check.

3. The check evidences the actual transfer to the Comptroller on December 19, 1991, of property of the Debtor in the amount of $4,382.00 (the "Transfer"), within

90 days before the date of the filing of the voluntary petition herein.

4. The check was issued as payment for the 1990 corporate income tax liability of Creative Goldsmiths.

5. Creative Goldsmiths filed its corporate income tax return on a fiscal year basis.

6. Creative Goldsmiths' fiscal year ended March 31.

7. The original due date for the Creative Goldsmiths' corporate income tax return was June 15.

8. The Comptroller of the Treasury has authority to grant corporations a six month extension of time in which to file corporate income tax returns by virtue of COMAR 03.04.03.04.

9. If the tax is not paid on the original due date of the return, the Comptroller imposes interest and penalties.

10. Creative Goldsmiths requested and received a six month extension to file its 1988 corporate income tax return.

11. Creative Goldsmiths filed its 1988 return in December, 1989, and paid the tax due on the return in December, 1989.

12. Creative Goldsmiths requested and received six month extension to file its 1989 corporate income tax return.

13. Creative Goldsmiths filed its 1989 return in December, 1990, and paid the tax due on the return in December, 1990.

14. The Comptroller has produced hard copies of Creative Goldsmith's 1988 and 1989 extensions and corporate income tax returns.

15. The Comptroller has been unable to locate the hard copy of the 1990 corporate income tax return.

16. The Comptroller keeps summaries of the corporate income tax returns on its computers.

17. These summaries are kept in the ordinary course of business.

18. The computer records for Creative Goldsmiths show that Creative Goldsmiths requested and received a six month extension to file its 1990 corporate income tax return.

19. The computer records for Creative Goldsmiths shows [sic] that Creative Goldsmiths reported a taxable income of $62,162.00, additions to income of $4,844.00, resulting in a modified taxable income of $62,607.00 after application of the apportionment factor. This resulted in a tax due of $4,382.00.

20. The computer records for Creative Goldsmiths also show that the Comptroller imposed a penalty of $1,095 and interest of $557.48.

21. The Comptroller's only records for the corporate income tax liability of Creative Goldsmiths are those for the tax years of 1988, 1989 and 1990.

22. That at the time of the Transfer, Creative Goldsmiths was insolvent.

23. That the Transfer enabled the Comptroller to receive more than the Comptroller would have received if

— (a) the case were a case under Chapter 7 of the Bankruptcy Code; (b) the Transfer had not been made; and (c) the Comptroller received payment of the 1990 corporate income tax liability of the Debtor to the extent provided by the provisions of the Bankruptcy Code.

DISPOSITIVE STIPULATIONS

24. That if the above facts support a finding that the Transfer was in the ordinary course of business, the same is not avoidable under 11 U.S.C. §547 and the Comptroller shall keep the $4,382.00 already paid.

25. That if the above facts do not support a finding that the Transfer was in the ordinary course of business, the same is avoidable under 11 U.S.C. §547 and the Comptroller shall pay the $4,382.00 to the Trustee.

/s/ Roger Schlossberg/
with permission
Roger Schlossberg
Schlossberg &
Associates
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(301) 739-8610
Attorney for Plaintiff

/s/ Sylvia J. Brokos
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Telephone:
(410) 225-1562
Attorney for
Comptroller

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

(Filed Nov. 20, 1997)

No. 96-1895
CA-95-2693-PJM
BK-91-11468-SD

In Re: CREATIVE GOLDSMITHS OF WASHINGTON, D.C., INCORPORATED

Debtor

ROGER SCHLOSSBERG, Trustee

Plaintiff – Appellant

v.

STATE OF MARYLAND, Comptroller of the Treasury;

Defendant – Appellee

UNITED STATES TRUSTEE

Party-in-interest

v.

UNITED STATES OF AMERICA

Intervenor

On Petition for Rehearing with Suggestion for Rehearing In Banc

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The United States filed a petition for rehearing with suggestion for rehearing in banc.

A member of the Court requested a poll on the suggestion for rehearing in banc. The poll failed to produce a majority of the judges in active service in favor of rehearing in banc. Judges Widener, Murnaghan, Ervin, Michael and Motz voted to rehear the case in banc, and Chief Judge Wilkinson, Judges Russell, Wilkins, Niemeyer, Hamilton, Luttig and Williams voted against rehearing in banc.

The Court denies the petition for rehearing with suggestion for rehearing in banc.

Entered at the direction of Judge Niemeyer for the Court.

For the Court,

/s/ Patricia S. Connor
CLERK